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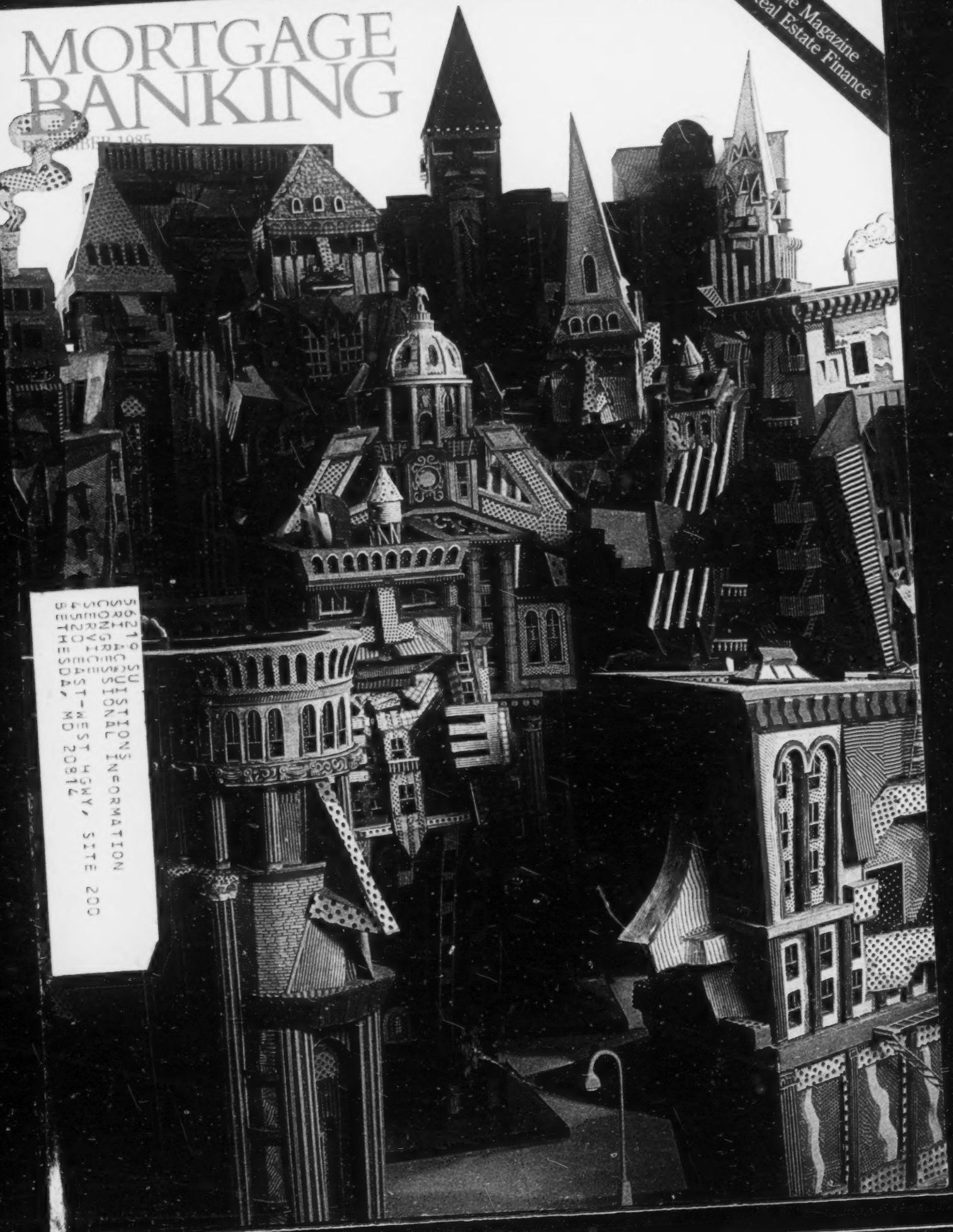
MORTGAGE BANKING

DECEMBER 1985

The Magazine of Real Estate Finance



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MORTGAGE BANKING

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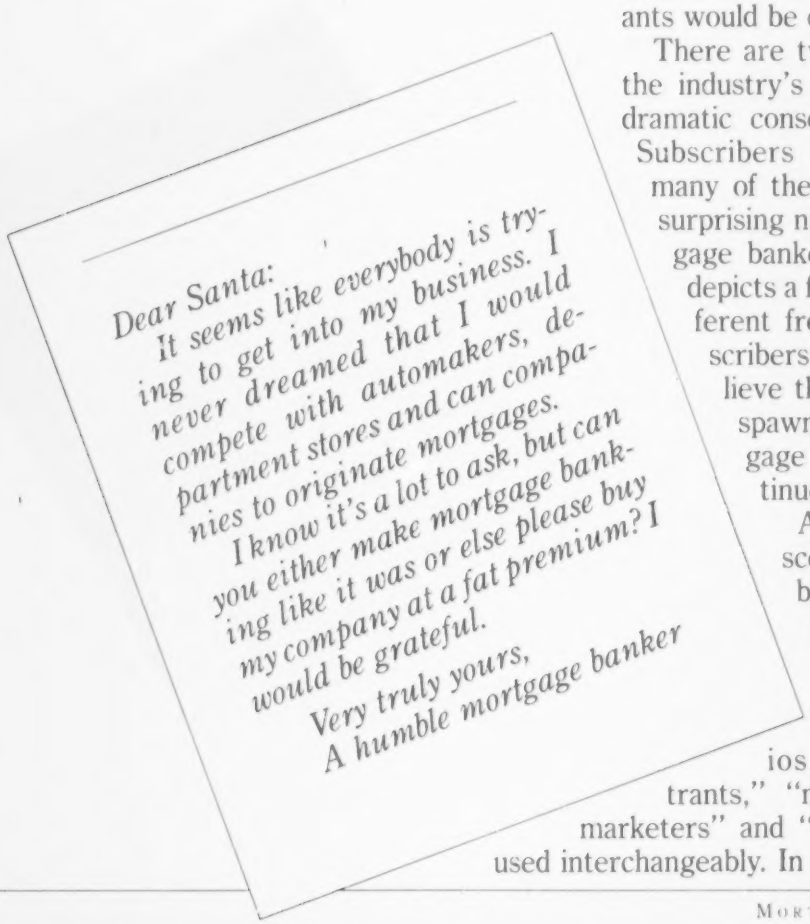
BRAVE NEW WORLD FOR MORTGAGE BANKING?

By Scott A. Shay


Dear Santa:
It seems like everybody is trying to get into my business. I never dreamed that I would compete with automakers, department stores and can companies to originate mortgages.
I know it's a lot to ask, but can you either make mortgage banking like it was or else please buy my company at a fat premium? I would be grateful.
Very truly yours,
A humble mortgage banker

Many mortgage bankers view the onslaught of new entrants into the industry with the same ambivalence as the humble mortgage banker. Some mortgage bankers welcome the entrants because they provide opportunities to sell out or merge with larger entities. The fondest wish of many originators is to have a General Motors or Metropolitan Life as a parent to bankroll them. Further, such companies which are making a major push in a new industry, are frequently the best premium payers. At the same time, other mortgage bankers are gamely preparing to compete with the newcomers. They reckon that the experience and particular niches they possess will enable them to take market share from entrepreneurial firms suddenly bent, or broken, into the corporate acquiror's mold. However, these eager competitors are also seeking mergers and alliances with other mortgage bankers to bolster weaknesses that the corporate giants would be quick to exploit.

There are two principal scenarios for the industry's future. The first depicts dramatic consolidation in the industry. Subscribers to this scenario include many of the newcomers as well as a surprising number of traditional mortgage bankers. The second scenario depicts a future that is not much different from the recent past. Subscribers to the second scenario believe that the forces which have spawned diversity in the mortgage banking industry will continue to do so.

After discussing these two scenarios, some motivations behind some of the recent major mortgage banking acquisitions will be described. Throughout the discussion of the scenarios, the terms "new entrants," "mass originators," "mass marketers" and "corporate giants" will be used interchangeably. In the section, "The hopeful

ILLUSTRATION BY JIM STARR

megamortgage bankers," the important differences that make one group of new entrants very different from the other will be described.

Scenario 1—Fasten your seat belts

All three key components of mortgage banking—origination, secondary marketing and servicing—have been remolded by the development of an efficient mortgage securities market. All three are also susceptible to powerful economies of scale. Much has been written about the revolution in secondary marketing and the requirements of scale in the secondary markets, so the story will not be recounted here. However, just as fundamental, is that origination and servicing have also become scale businesses.

The most powerful force changing the origination business is the consumer's increasing price sensitivity. The volatile economic times of the 1970s and 1980s and the deregulation of interest rates on deposits of the 1980s has taught consumers that shopping for the best rates on financial products can be very rewarding. In response, mortgage bankers have competed ferociously with each other on interest rates and origination points. Whereas, mortgage bankers used to make money on originations, now they are typically content with profits from the subsequent servicing of the loan. As one mortgage banker put it, "We used to measure our up-front profits in points. Now, we count basis points." Indeed, the lexicon of originating has been altered. Now, mortgage bankers define success as breaking-even on originations so as to put "two-point servicing on the books."

With mortgage bankers largely willing to originate loans at break-even or at a small profit and with most moderately sized mortgage bankers looking at the same secondary market prices, the low cost producer of loans should be the winner. The question then becomes how to squeeze the costs out of the origination process.

Traditional mortgage bankers have taken several lines of attack. First, they have tried to rationalize their branch system to eliminate unnecessary expenses. Mortgage bankers have also started computerizing the origination process to make it more efficient. Although the savings in these areas have been impressive in absolute terms, they have tended to be relatively small compared to total origination costs. This is because personnel and particularly commission costs comprise such a large portion of origination expense for a traditional mortgage banker. The industry has also focused on the bulk producers of mortgage loans, such as builders, to reduce origination costs. Alas, the builders have taken back a lot of the mortgage bankers' gains through negotiation of the services and terms to be provided.

Some of the new entrants have determined to radically alter the way mortgages are originated in this country. The underlying theme has been to eliminate the commissioned loan originator based on the assumption that the consumer would prefer fewer origination points or a lower interest rate to personal "handholding." These newcomers often use advertisement and prequalification programs to reach the consumer before he or she has actually bought the home. Because there are neither loan agents nor branches to support, these programs typically charge fewer origination points or slightly lower rates. Consumers are basically offered a no-frills mortgage. Applications are taken by mail, questions are answered via a toll-free phone number and loans are closed through subcontractors such as title companies. Sponsors of these programs reason that homebuyers would rather know the mortgage they can carry before shopping for a house. Consumers have indicated in one study that prequalification programs reduce the stress of buying a home. The consumer knows that the agreed mortgage will be available so long as his or her application was truthful. Home sellers are also more comfortable with prequalified buyers because it is less likely that the sale will fall through due to financing problems.

The new entrants are also seeking other innovative low cost methods of targeting specific consumer groups. One of the increasingly popular methods is for mortgage bankers to align with corporations, trade unions, professional associations and other groups to offer mortgages. The mortgage banker then becomes the "official" originator of the group and can adver-

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tise rates and services through the group's newsletters and other member communications. Managements of these organizations are enthusiastic about mortgage programs because they permit the group to offer a valuable service to its members, at little cost to the group. At the same time, mortgage bankers can offer cheaper mortgages because of reduced marketing and processing costs because these mortgages would also be handled by phone and mail.

These originators are pushing the "commoditization" of mortgages down from the secondary markets to the consumer. The same phenomenon struck the high cost liability gatherers, namely, banks and S&Ls, when the money market funds grew $141 billion from 1980 to 1982. While it may seem intuitive that consumers would want personal banking service, they have demonstrated a surprising willingness to entrust their life savings to post office box numbers. Similarly, the new entrants believe that the mortgage market will be very responsive to a mortgage-by-mail program if it proves cheaper for the homebuyer.

Yet the mass originators also do not want to originate for origination's sake. Instead, they are expecting loan servicing to provide profits. Servicing mass originations makes sense for several reasons. The most important benefit of mass originations is that it quickly builds a large portfolio of high balance loans. Servicing costs are very sensitive to volume as portfolio size exceeds $3 billion. Dr. Victor Cholewicki pointed out in "Servicing Costs: Putting the Pieces Together," August 1985, *Mortgage Banking* that servicing costs become vulnerable to diseconomies of scale at the $600 million level. This is probably true. However, what the study did not point out is that the diseconomies probably persist only until about the $2 billion level. Although no public aggregate data exists on the larger servicing operations, it is believed that at the $2 billion level, firms are able to restructure their servicing operations to utilize technologies appropriate for large scale data processing. Also, further dramatic economies of scale are available for portfolios exceeding $10 billion. This view of servicing costs results in a stepped cost curve shown in Chart 1.

Chart 1 implies that servicing is far more valuable to servicers of $10 billion or more enjoying marginal costs of servicing $30 per loan than to $1.5 billion servicers coping with marginal costs of $70 per loan. Servicing is worth more to the lower cost servicer because more servicing revenues fall to net income, which generates a higher net present value over the life of the serviced loans. Thus, given the same loan servicing fees, the larger servicer will be much more profitable.

Large servicers have a strong ad-

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CHART 1

Marginal Cost of Servicing Per Loan
GROUPED BY DOLLAR VOLUME SERVICED

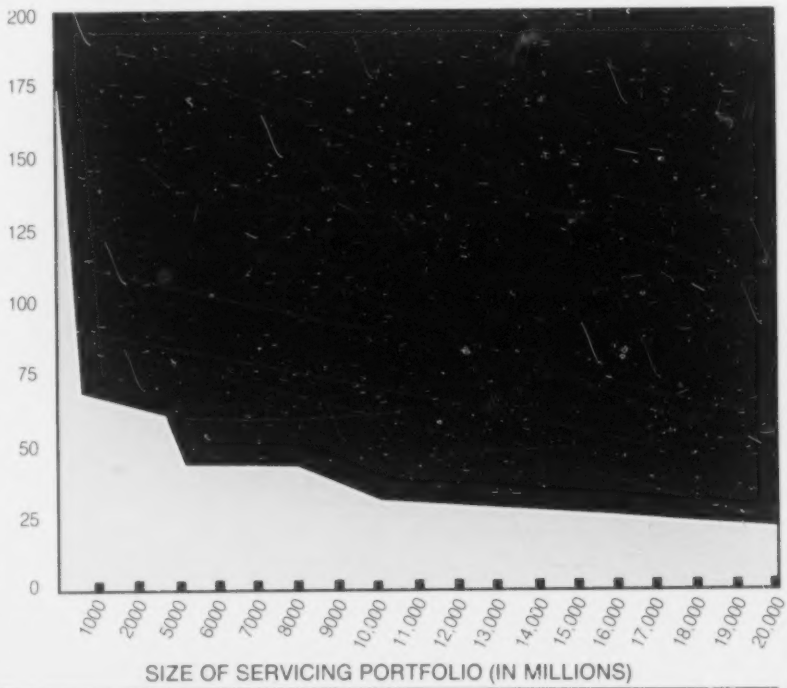

CHART 2

Top 100 Mortgage Servicers in the U.S.

Dollar Volume of Mortgages Serviced (in millions)

Rank	1984	1983	1982	1981	1980	1979	Compound Growth Rate
1	$17,627.5	$18,113.2	$17,366.0	$11,736.9	$11,305.4	$10,559.5	10.8%
10	6,878.5	5,596.7	4,446.1	3,788.2	3,339.4	2,691.5	20.6
25	4,166.7	3,868.9	3,218.3	2,530.9	2,164.8	1,734.9	19.2
50	2,436.2	2,195.0	1,746.5	1,417.0	1,228.3	1,172.0	15.8
75	1,700.0	1,490.0	1,201.1	1,068.4	1,003.4	846.7	15.0
100	1,300.0	1,071.7	919.0	772.5	699.5	558.7	18.4

Source: *The American Banker*

Average Compound Growth Rate for Servicing Increase 1979-1984 — 16.6%

Compound Growth Rate of Total Residential Mortgages Outstanding — 7.8%

vantage in reaching the far right corner of the curve depicted in Chart 1, in that they can also purchase servicing profitably. Purchased servicing provides both the benefit of lowering the servicer's new incremental costs as well as crucial tax benefits which permit the acquiror of servicing to shelter the servicing cash flows. Servicing acquirors enjoy an amortizable tax basis in purchased servicing that permits them to pay more for the servicing than it is worth to the seller. The reasoning is the same as for income producing real estate: the acquiror can use the depreciation of the purchase price to shelter income from the property. As a result, the property is worth more to the buyer than to the seller. Whenever an asset is worth more in the hands of a buyer than in the hands of a seller, it tends to encourage more transactions than otherwise.

Over the last year, we have witnessed unprecedented activity in the servicing transfer market as firms seek to acquire portfolios that will drive their expenses down the servicing cost curve. Chart 2 demonstrates that just to maintain relative position on the *American Banker's* Top 100 mortgage bankers list, firms had to add to their servicing portfolios at an average compound growth rate of 16.6 percent versus a compound growth rate of 7.8 percent in total mortgages outstanding. As both new entrants and traditional mortgage bankers increase their portfolios, the disparity between the value of servicing to the large servicers versus the small servicers will become even greater.

Certainly in such an environment, smaller servicers would have to reevaluate their competitive advantage. They would be producing servicing that had substantially less value to them than to their competitors. Even today, it is becoming clear to servicers that servicing is not worth two points to the originator unless it is sold, because the originator does not have an amortizable tax basis to shelter the servicing income. Therefore, coupling the economies of scale in servicing with the tax advantages of purchased servicing creates a powerful force for dramatic consolidation in servicing.

Proponents of this scenario argue that dramatic consolidation of the industry is consistent with the growing concentration of the rest of the financial services industry. They argue that the current structure of the mortgage banking industry results from the fragmented nature of depository institutions in the United States with over 18,000 banks and S&Ls. Just as depositories are consolidating as fast as law and regulation will permit, so will mortgage banks consolidate even more quickly because of the lack of legal barriers.

Advocates of this scenario contend that in 10 to 15 years, there will be 50 scale mortgage bankers, with 10 to 15 dominant firms heading the list. Such firms would be mass market originators with huge efficient servicing operations. Smaller mortgage banks would either be acquired by scale participants or would merge with each other to form larger economic entities. As the consolidation phase proceeded, prices for smaller mortgage banks would decline.

This scenario clearly calls for rapid action by mortgage bankers to either grow, merge, sell, or make sure that they have a niche that can withstand tremendous attack. It also means that those considering a sale of their company should do so sooner and not later. But take heart, there is an alternative forecast for mortgage bankers.

Scenario 2—Do not believe everything the Harvard MBAs tell you

Some mortgage bankers yawn at Scenario 1 and tales of massive consolidation. They make three key points: 1) originating loans by phone is not so easy for mortgage bankers or attractive for consumers, 2) servicing costs are not so susceptible to economies of scale, and 3) to the extent that alternative mortgage banking methods do take market share, it will come from the S&Ls and banks.

When a consumer is shopping for a mortgage, he or she is not likely to be as dispassionately rational as Scenario 1 would indicate. Most mortgage banking leads come from real estate brokers who have just signed a buyer to a purchase contract. Typically, the homebuyer is making his or her largest financial decision in a decade and is experiencing a variety of emotions, not the least of which is anxiety. It is at such a time that a personal touch is required. A homebuyer will naturally feel more comfortable talking to a local mortgage banker than dealing with a disembodied voice on an "800" number. Even if a buyer does check to see what rates the large entities are quoting, a resourceful loan originator can frequently coax the consumer back even if another firm has a slightly lower rate.

Subscribers to Scenario 2 are skeptical that servicing costs are really as sensitive to volume as Chart 1 indicates. They point to the advance findings of the Mortgage Bankers Association cost study that indicate that servicing costs flatten at the $600 million in servicing level.

Finally, there is the issue of where market share gains would come from if the mass marketers did have some impact. Traditionalists point out that mortgage bankers originate less than 30 percent of new residential mortgages (see Chart 3). In 1984, originations by mortgage bankers fell to 22.9 percent from 28.8 percent in 1983 due to teaser rates on ARMs being offered by S&Ls. Mortgage bankers' market share should bounce back in 1985 because fixed-rate loans have become more affordable and S&Ls have retreated from offering teaser rate ARMs. Thus, there is plenty of room for aggressive originators to take market share from banks and S&Ls. After all, mortgage bankers would argue, thrift and bank loan originators are less aggressive because they are not typically compensated on a commission basis and would, therefore, be the first to lose the consumer. It may be that thrifts and banks, which frequently have even higher cost structures than mortgage bankers, would suffer the most from new competition.

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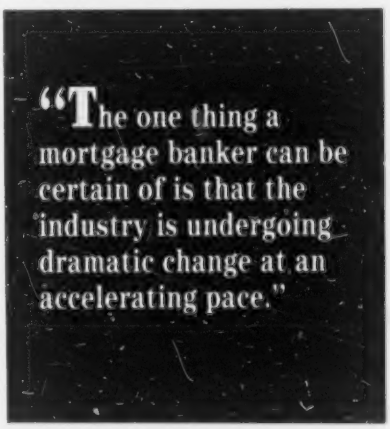

"The one thing a mortgage banker can be certain of is that the industry is undergoing dramatic change at an accelerating pace."

CHART 3

Originations of Long-Term Residential Mortgage Loans
Percentage Originated by Selected Lenders
1-4 Units

Year	Mortgage Bankers	Savings and Loans	Commercial Banks	Others (a)
1984	22.9%	49.4%	27.3%(b)	0.4%
1983	28.8	42.1	28.7 (b)	0.4
1982	29.4	36.7	24.5	9.4
1981	24.4	42.7	22.1	10.8
1980	22.0	45.7	21.5	10.8
1979	24.2	44.2	22.1	9.5
1978	18.6	48.6	23.7	9.1
1976	14.0	54.9	21.7	9.4
1974	19.3	45.8	23.9	11.0
1972	17.5	48.4	23.3	10.8
1970	25.0	41.6	21.9	11.5
1965	21.3	44.8	21.0	12.9
1960	19.3	50.9	13.2	16.6

a) Includes mutual savings banks, life insurance companies, and federal, state and local credit agencies.
b) Due to lack of detailed information, figures for 1984 and 1983 include mutual savings banks.
Sources: "The Secondary Residential Mortgage Market," *Salomon Brothers Bond Market Research*, April 1983 and "Lender Activity," *Mortgage Banking*, July, 1985.

CHART 4

Selected Major Acquisitions of Mortgage Bankers
(Dollar Amounts in Millions)

Date Completed	Acquiror/Mortgage Banker	Price	Servicing Portfolio
06/83	Bank of Boston Corp./ Stockton, Whatley, Davin & Company	$120.0	$ 3,618
08/83	Mercury Savings Association/ Baldwin-United Combined Mortgage Company	100.0	4,429
12/84	Fleet Financial Group/ Bankers Mortgage Corp.	85.0	3,763
04/84	The Commonwealth Financial Group/Jersey Mortgage Company	30.0	1,968
08/84	Philadelphia Savings Fund Society/ First Anaheim	90.0	3,200
08/84	Paine Webber Inc./ Rouse Real Estate Finance	50.5	2,123
01/85	Pacific First Federal Savings Bank/Transamerica Mortgage Company	60.5	3,096
02/85	Owens-Illinois, Inc./ Alliance Mortgage Company	115.0	5,250
04/85	Integrated Resources Inc./ Wells Fargo Mortgage Company	108.0	6,241
04/85	Travelers Insurance Co./ Brokers Mortgage Service Co.	32.5	650
05/85	American Can Corp./ Berg Enterprises, Inc.	125.0	1,497
05/85	General Motors Corp./ Colonial Mortgage Services Co.	190.0	7,511
06/85	General Motors Corp./ Norwest Mortgage Inc.	125.0	10,266
08/85	Metropolitan Life Insurance Co./ CrossLand Capital Corp.	125.0	8,500
08/85	The Commonwealth Financial Group/General Electric Mortgage Corp.	55.0	3,000

Meanwhile, the scrappy mortgage bankers will hold their own.

Which scenario is right?

The answer is that they are both right, to varying degrees. The first scenario is correct in asserting that: 1) a mortgage banker's core value is in servicing, 2) innovative direct marketing of loans to consumers is far cheaper than traditional origination methods and at least a significant minority of consumers will respond to more attractive mortgage terms, 3) servicing costs fall dramatically at higher servicing volumes, and 4) the first three factors will lead to the creation of some servicing giants.

The second scenario also makes some unassailable points: 1) a significant number of consumers will always want and need personal attention through the mortgage application and approval process, 2) mortgage bankers are generally hard workers and will find profitable origination niches, 3) entities other than mortgage banks originate more than 70 percent of new mortgages and are the ones who really ought to be worrying about losing market share.

Putting all of this together leads to the conclusion that there will probably be fewer mortgage banks in the future than today, with origination volumes and servicing portfolio sizes far exceeding current averages. The top 10 servicers will probably be larger by a multiple of today's top firms, they will be national in scope, and quite profitable. There would probably be a second tier of 25 or so large regional or smaller national firms that would compete with the top 10 but would probably be less efficient and less profitable.

Finally, there would be a tier of perhaps 300 smaller firms that would successfully exploit niches of profitable originations and would supply the personal attention that some consumers would be willing to pay for. Many of these firms would sell their servicing to the larger servicers or would develop expertise in servicing particular types of loans (e.g. FHA Section 237 loans). We are already seeing the beginning of this trend as many smaller servicers have entered into correspondent relationships with larger mortgage bankers. Banks and S&Ls would

continued

see their share of originations shrink unless they can continue to successfully market loans such as ARMs, which are not attractive to secondary market investors but which can be held in bank and S&L portfolios.

This forecast presents mortgage bankers with several profitable avenues. They could attempt to grow to become megaservicers or strong regional firms through internally generated growth or by linking with merger partners. Intraindustry mergers may regain the popularity they lost in 1983 when outsiders began bidding up prices to gain entry to the industry.

Other mortgage bankers will focus on particular products or distribution niches. Some mortgage banks will link-up with regional banks or S&Ls to create a regional presence, while others will enter joint ventures with real estate brokers. Many will become mortgage brokers selling their servicing on a flow (loan-by-loan) basis. Still, others will undoubtedly find a host of niches, as they examine the $200 billion origination market. Chart 4 lists the major mortgage banking acquisition transactions over the past two years. Chart 5 breaks the list down by depository and nondepository entrants.

CHART 5

Selected Major Acquisitions of Mortgage Bankers by Type of Acquiring Institution

Acquiror/Mortgage Banker
Depositories
Bank of Boston Corp./ Stockton, Whatley, Davin & Company
Mercury Savings Association/ Baldwin-United Combined Mortgage Company
Fleet Financial Group/ Bankers Mortgage Corp.
The Commonwealth Financial Group/ Jersey Mortgage Company
Philadelphia Savings Fund Society/ First Anaheim
Pacific First Federal Savings Bank/ Transamerica Mortgage Company
The Commonwealth Financial Group/ General Electric Mortgage Corp.
Nondepositories
Paine Webber Inc./ Rouse Real Estate Finance
Owens-Illinois, Inc./ Alliance Mortgage Company
Integrated Resources Inc./ Wells Fargo Mortgage Company
Travelers Insurance Company/ Brokers Mortgage Service Co.
American Can Company/ Berg Enterprises, Inc.
General Motors Corporation/ Colonial Mortgage Services Co.
General Motors Corporation/ Norwest Mortgage Inc.
Metropolitan Life Insurance Co./ CrossLand Capital Corp.

The hopeful megamortgage bankers

So far, all of the large acquirors of mortgage banks have been categorized under the rubric of the "new entrants." The situation is actually much more complex. In a sense, the nomenclature is a misnomer because almost all of the "new entrants" have entered the business by purchasing existing mortgage bankers. In some cases, acquirors have merely provided new capital, perhaps some complementary financial products and best wishes for continued profitability. Depository institutions have, for the most part, bought mortgage banks not to change the nature of the industry, but to regain the ground they have lost as efficient mortgage suppliers.

In considering the situation of the depositories in general and the thrifts in particular, it is not surprising that they have a keen interest in mortgage banking. Many thrift managers believe that liability deregulation has taken the profit out of mortgage spread lending. They reason that if they take into portfolio an adjustable rate loan that floats at 200 basis points over their cost of funds and if their operating expenses are 160 basis points (the national average), there is little after-tax profit. If a thrift attempts to fund a 30-year, fixed-rate loan on a duration matched basis, the best that can be hoped for is a 100-125 basis point spread, producing a loss after operating expenses. Therefore, many thrift managers reason, it is more sensible to build customer relationships by originating and servicing the mortgage loans but leaving the long-term funding to someone else. Also, the thrifts face a well-publicized capital shortage which makes them even more reluctant to leverage their scarce capital on low spread business.

Depositories enjoy an important advantage in mortgage banking over nondepositories through depositories' more efficient use of escrows. Mortgage banking subsidiaries of depositories can direct the mortgage escrow funds to their parent bank or thrift.

Thrifts and banks have made use of their mortgage banking customer relationships to cross-sell products such as credit cards, second mortgages, car loans and even deposits. PSFS, for example, offers a wide range of financial products through its thrift as well as its other financial service subsidiaries. As it focuses its three acquired mortgage bankers on cross-selling, it has tremendous potential. Commonwealth Financial of Texas has created an extensive mortgage banking network which has actually dwarfed its savings and loan operations. Yet the mortgage banking operations make the thrift more profitable by supplying escrows, as well as higher rate consumer loans appropriate for the S&L's portfolio. Fleet Financial Group is envied by many other banks because, among its other successes, it has built the fourth largest mortgage banking operation in the U.S. from an almost standing start. Many analysts believe that the primary reason that Fleet's stock tends to be valued by the stock market above comparable bank stocks is because of Fleet's mortgage banking presence and resulting off-balance sheet servicing values. Fleet has created an interstate network of financial services/mortgage banking offices that could give it an advantage in the interstate banking sweepstakes.

> "The future will be challenging for mortgage bankers of all stripes. No scenario analysis can accurately anticipate the pitfalls as well as opportunities that lie ahead."

Thus, depositories typically view mortgage banking as a more efficient means of delivering mortgages to consumers with the added benefits that it does not require use of their balance

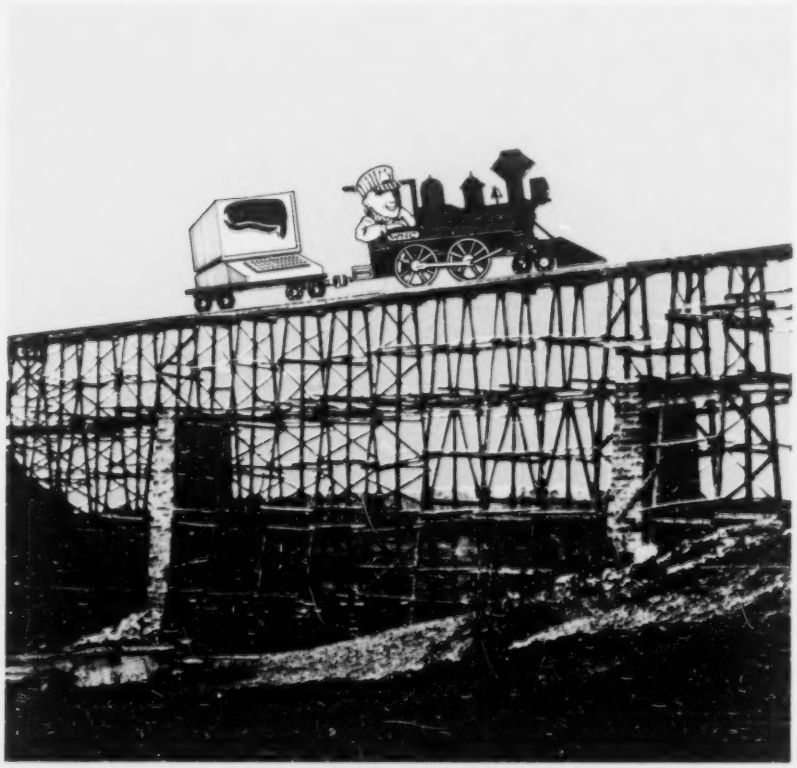
continued

sheets for long-term funding and it helps depositories regain mortgage market share that they have lost. Depositories' mortgage subsidiaries, on the whole, have competed on the same terms as other mortgage bankers and have not indicated an interest in radically changing their distribution methods through mass marketing efforts.

Nondepository entrants have generally had much more ambitious plans for their newly acquired subsidiaries. The nondepository entrants tend to view the mortgage market along the lines of Scenario 1 and, therefore, want to become very large very quickly. Metropolitan Life has already announced that it plans to harness the $35 billion of Century 21 gross real estate sales for its other recently acquired subsidiary, CrossLand Mortgage. Metropolitan must believe that it can bypass the commissioned loan originator by owning the real estate broker. Metropolitan also intends to offer other insurance and financial products through its Century 21 offices and through its nonCentury 21 mortgage servicing relationships. This approach to the business makes the consumer's real estate-mortgage relationship the linchpin of a much larger relationship. It is a very bold move. However, Metropolitan does face several challenges in executing its strategy. The biggest challenge is persuading all the independent Century 21 offices and independent contractor-brokers to cooperate. Unlike its own agency force, Metropolitan does not control the product (i.e., houses as opposed to insurance), which is the broker's core product and the biggest generator of his or her compensation. Without substantial incentives, Century 21 brokers will continue to focus on selling homes and not mortgages or insurance. Metropolitan will face a delicate problem balancing necessary incentives with cost effectiveness. If Metropolitan can successfully carry out the strategy, the combined entity could be an awesome force.

American Can's acquisition of Berg Enterprises, and indirectly, Berg's Margaretten and Company mortgage subsidiary, allows Margaretten to extend its foray into direct marketing. Even before the acquisition, Margaretten had begun prequalifying homebuyers for mortgages in certain K-Mart stores. Prequalification is a powerful tool that reaches the homebuyer before the Realtor. Margaretten is poised to substantially expand this effort with the expertise of another American Can subsidiary, The Fingerhut Companies, which has an excellent reputation for direct mail marketing. American Can can reach other potential customers through its insurance and mutual fund operations. Interestingly, another New Jersey-based mortgage banker, Brokers Mortgage Service, which was recently acquired by Travelers Insurance, has also made a major effort in direct marketing to the consumer.

No discussion of mortgage banking entrants would be complete without mention of General Motors' stunning back-to-back purchases of the servicing operations of Norwest Mortgage Company as well as its purchase of Colonial Mortgage Service Company, which combined, made GM the second largest mortgage banker in the United States. Much has been written about GM's potential in mortgage banking



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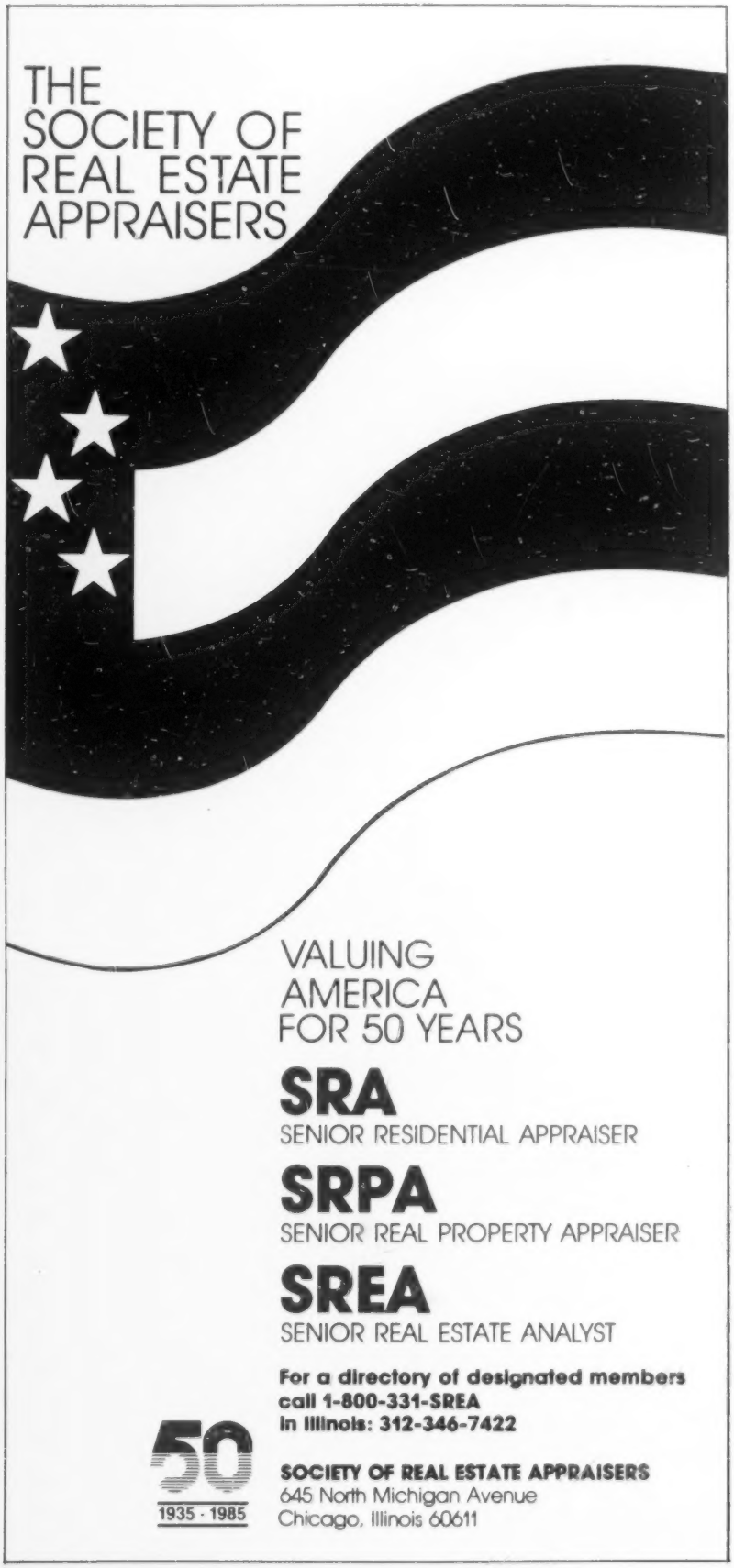

which, through its subsidiary General Motors Acceptance Corporation, has $20 billion in mortgage servicing, $57 billion in consumer finance receivables and $4.6 billion in GMAC equity. Just its base of over 680,000 GM employees and 6 million GMAC customers will provide a formidable direct marketing base. GM's EDS subsidiary could also be a formidable asset for its mortgage servicing operations. EDS has a reputation for creating low cost data processing techniques for the financial services industries. GMAC clearly has the servicing mass to justify extensive technological improvements in current servicing methods. The question in mortgage banking circles is not whether GM has the potential to be a powerful competitor. Clearly it does. The real question is whether GM will fulfill its potential given what would seem to be such important and consuming distractions as its new Saturn operation, its Hughes acquisition and the fiercely competitive nature of the automobile market.

What is a mortgage banker to do?

The one thing a mortgage banker can be certain of is that the industry is undergoing dramatic change at an accelerating pace. The worst strategy is to simply ignore the tumult. Rather, mortgage bankers need to assess their competitive strengths and weaknesses. Companies with high servicing costs, but a good origination network might want to either restructure their operations, acquire an efficient servicer or merge with a superior servicer. Alternatively, such companies should consider selling their servicing on a flow basis and becoming mortgage brokers. Companies with strong servicing operations might find it profitable to linkup with a volume originator because originations are more valuable to a strong servicer. Some firms have all the competitive weapons but lack capital. These entities might seek financing from the public markets as well as from merger partners.

The future will be challenging for mortgage bankers of all stripes. No scenario analysis can accurately anticipate the pitfalls as well as opportunities that lie ahead. Mortgage bankers are uncommonly resourceful entrepreneurs and these times of change will be profitable for many. □

Nursing Home Investment:

GROWING OPPORTUNITIES

"He who refuses to embrace an unique opportunity loses the prize as surely as if he had failed."
William James
The Will to Believe

In recent years, growing numbers of institutional investors have allocated a portion of their investable funds to the financing of nursing homes and for the most part, have accumulated a trouble free portfolio at premium yields, secured by properties which have appreciated significantly in value. These few investors recognized a combination of forces, all of which point to a very strong market for nursing homes in the years to come and to increasing professionalism among nursing home operators to serve that continually growing market.

Factors *These forces include: ▪ The graying of America—the astonishing growth of the over-65 and the over-75 age categories representing the primary market for nursing homes. ▪ The increased personal wealth of the elderly which allows a significant proportion of nursing*

Nursing Homes *continued on page 28*

Stephen F. Wood, CMB

Nursing Homes *continued from page 26*

home patients to pay for the service from their own resources rather than using various government programs.

- The change in the Medicare reimbursement system regarding hospitals effective in 1983. The introduction of the Prospective Payment System (PPS) and its Diagnostic Related Groups (DRGs) have significantly shortened stays and reduced occupancy in hospitals, with many of these patients being discharged to nursing homes thereby increasing nursing home occupancy.

- The changing life-style of Americans reflected in the large number of households where both the husband and wife work full-time and the higher mobility of working families. This changing life-style dramatically reduces the ability of families to care for elderly parents at home.

- The strong trend among all states to reduce the population of mental institutions by early releases of mentally disabled individuals, many of whom are unable to adequately care for themselves and end up in nursing homes. In 1960, 805,000 persons representing approximately .44 percent of the national population resided in mental institutions. By 1980, this number had declined to 394,000 persons representing .17 percent of the population. Over the same time span, the population residing in nursing homes increased from 470,000 (.26 percent of the population) to 1,426,000 (.63 percent of the population). Similarly, the population in TB and chronic illness hospitals has declined from 1960 to 1980, indicating further transfers to nursing homes.

While these forces are operating strongly to increase the demand for nursing home beds, there are other forces at work at the present time which tend to limit the availability of new nursing home construction. The Deficit Reduction Act of 1984 placed a severe restriction on the use of industrial development bonds. Many new nursing homes had been constructed using the tax-exempt IDBs, but this source of financing is now much more difficult to obtain because of the more stringent restrictions. Additionally, in order to help contain reimbursement costs, primarily Medicaid, some 49 of our 50 states utilize the "certificate of need" process under which no new or expanded facility may be constructed without first obtaining a certificate of need from the state agency. Such certificates are increasingly more difficult to obtain in most areas. In fact, nine states have issued moratoriums on the issuance of certificates of need and more are leaning in this same direction in order to help control costs.

Stephen F. Wood, CMB, is president of Equitable Mortgage and Investment Corporation, an independent mortgage banking firm in Nashville, Tennessee.

Economic opportunities

The obvious factors of an increasing demand for nursing home beds and a more restricted supply of such beds have not been overlooked by the business and investment community. Existing corporations engaged in the owning and operating of nursing homes have expanded significantly in recent years and many new corporations and limited partnerships have entered the business. The majority of nursing homes in the United States are still owned by individuals or small groups and this segment has been targeted by the professional, corporate and other multifacility operators for acquisition. Some major proprietary hospital corporations have entered the field or expanded their involvement in the nursing home industry.

An institutional investor engaged in the mortgage financing of income property has this attractive scenario:

The financing of nursing homes results in premium yields secured by facilities for which there exists an excessive market demand and limited supply, with virtual assurance that there will not be an "overbuilding" situation as exists with many other types of real estate. A well-managed nursing home will generate cash flow and can produce far better debt coverage than the more traditional real estate mortgages. Professional management is available with proven track records and there are ample sources of cash equity investment to further reduce the mortgage exposure.

This is an attractive scenario, particularly in an economy where an abundance of investable funds is still available and the more traditional types of real estate are becoming overbuilt in almost every major city.

"Once fully occupied, a well managed nursing home will generate significant cash flow."

Given this attractive investment opportunity, let us examine the market in more detail. By far, the most compelling force is the amazing demographics. According to the American Health Care Association, 5 percent of the over-65 population live in nursing homes, while 25 percent of the over-85 population live in nursing homes.

Medical science may extend the average life span, but it has not necessarily resolved the medical problems that accompany greater longevity, hence, the great demand for nursing care.

The U.S. Bureau of Census estimates that population growth from 1980 to 2000 will average 16.5 percent for the total population. The 75-84 age group, however, will increase 47.9 percent, while the 85+ age group will increase 60.9 percent. A more detailed breakdown of this growth is shown in Table I.

Nursing homes are a relatively new phenomenon. Most were built after the late 1950s to care for people already receiving substandard care, or no care at all. Thus, there not only was a large immediate group to serve, but there was a rapidly expanding group of elderly adding to their numbers. As indicated in Table II, the average occupancy of nursing home facilities has increased steadily from 90.2 percent in 1969 to 94.7 percent in 1982. In many areas today, nursing homes are operating at virtually 100 percent occupancy with waiting lists.

In 1982, there were 19,500 nursing home facilities containing 1,500,000 beds for an average of 77 beds per facility. Of this amount, 20 percent of the total beds were operated by nonproprietary entities. Of the remaining 80 percent of the beds owned by proprietary entities, 79 percent were administrator-owned and available for acquisition and 21 percent were shareholder-owned. Since 1982, there has been a noticeable increase in professional multifacility operator activity in both the construction of new facilities and the acquisition of existing, administrator-owned facilities. This trend is expected to continue and to increase in intensity in the coming years and to significantly increase the price of existing facilities.

In its recent series on "The Elderly," the *Wall Street Journal* included the following comments in regard to capital needs.

"There is also the fear that, with the costs of building and running nursing homes rising so fast, someday not enough of them will be built to serve the people who really need nursing home care, unless those who don't need it are served in other ways. A recent federal study found that if present trends continued, the $23 billion a year that it costs to support nursing homes today would more than triple, to $76 billion, by 1990. Already, shortages of nursing home space in some areas mean that many elderly people must be kept in even more expensive hospitals until room can be found for them.

"Adding urgency to the whole problem is the fact that the sharpest rise in the country's elderly population is among persons 75 or older, a group especially vulnerable to such disabling illnesses as arthritis, heart disease and strokes. The National Institute of Aging expects that by the year 2000, the number of Americans 75 and over will have risen 53 percent since 1980, an increase almost twice that of the total 65-and-over group."

Recent statistics reveal that personal resources and family support provided 42.6 percent of the nursing

continued

TABLE I

Elderly Population Estimate, 1980-2000 (in millions)

Age Group	1980	1990	2000	Annual Rate of change 1980-1990	Annual Rate of change 1990-2000
65-69	8,780.8	10,006.3	9,110.2	1.3%	−0.9%
70-74	6,796.7	8,048.0	8,582.8	1.7%	0.6%
75-79	4,792.6	6,223.7	7,242.2	2.6%	1.5%
80-84	2,934.2	4,060.1	4,964.6	3.3%	2.0%
85+	2,239.7	3,460.9	5,136.3	4.4%	4.0%
Total	25,544.1	31,799.1	35,036.1	2.2%	1.0%

Source: U.S. Bureau of the Census, Population Estimates and Projections, Series P-25, No. 937, 1983.

TABLE II

Growth of Nursing Homes by Year, Beds, Size and Occupancy

Year	Number of Facilities	Number of Beds	Average Size	Residents	Occupancy
1963	13,086	507,530	39	—	—
1969	14,998	879,091	59	793,074	90.2%
1973	15,737	1,175,865	73	1,074,480	91.4%
1978	18,722	1,348,794	72	1,240,373	92.0%
1982	19,500	1,500,000	77	1,400,000	94.7%

Source: Data from National Center for Health Statistics, Composite of Several Surveys, Department of Health and Human Services, Washington, D.C.; AHCA estimates.

home receipts. Medicaid provided for 49.6 percent, with the remainder coming from miscellaneous sources including Medicare, health insurance, Veterans Administration, etc. Obviously, Medicaid, contributing almost half of the total nursing home receipts, is a significant factor.

Medicaid is a federal and state financed assistance program for needy and low income persons of all ages. States design their own programs within broad federal guidelines, resulting in variations from state to state. Medicaid pays for care for those who qualify in nursing homes certified as skilled nursing facilities (SNF) and intermediate care facilities (ICF). States are required to pay for these services at rates that are reasonable and adequate to cover costs incurred by efficient and economical facilities which provide care according to state and federal requirements. Each state develops its own formula for computing the rates paid to the nursing homes. States have the flexibility to restrain cost growth by developing nursing home reimbursement systems that include cost containment provisions and incentives for efficient operations, such as prospective payment rates and limitations on rates. An unlimited supply of nursing homes would strain a state's budget because it would create an unacceptable level of reimbursement. This situation could force the closing of facilities which would not be politically feasible. Therefore, fewer facilities for Medicaid dollars instead of less Medicaid dollars per facility may be the states' course of action in the near future.

The other important source of funds for nursing homes, individuals and families, provides the nursing home operator a greater margin of profits from the "private pay" patient. Individual facilities compete intensively for private pay patients by upgrading services and instituting cost efficiencies. This market is also expanding rapidly as indicated in a 1982 report published by FIND/SVP, the Information Clearing House, Inc. This report states that a solid 70 percent of the over-65 segment own their homes, of which 80 percent are mortgage free. Recent inflation in residential home prices has made this the single largest source of wealth among the elderly.

Also, the President's Council of Economic Advisors, in its most recent annual report, indicated that the source of income for the elderly has changed dramatically over the past three decades. The most important source of money for the majority of the elderly people today is social security, which, according to the report, accounts for about 40 percent of retirees' income.

Personal assets such as savings accounts, investments and private pensions account for 25 percent of retirees' income. Only a quarter of the work force was covered by pensions in 1950, but now half of all workers have them. In the future, more and more employees will fall under various pension plans.

The elderly have done relatively better in keeping up with rising prices in recent years than the population as a whole. Social security payments, tied by 1972 law to the rate of inflation, went up 46 percent in real terms since 1970, while wages and salaries of people still working withered by 7 percent. Prices increased 312 percent between 1950 and 1983, but the typical monthly social security payment jumped 905 percent.

The first economic law of supply and demand virtually assures that the long-term care industry will succeed financially in the immediate future. The nursing home will become the foundation for the community's care for the elderly. It will serve the patients from hospitals coming from one direction and residents from congregate care facilities coming from the other direction.

Given the irrefutable market forces indicating a favorable economic picture for nursing homes for years to come, what approach does the institutional investor take to participate in this financing market?

Costs

First, it must be recognized that there is a wide diversity of types of nursing homes, and that it is very difficult to come up with standard ratios which would fit all situations. Values of existing facilities might range from $15,000 to $18,000 per bed for a primarily Medicaid-oriented facility located in a small town and containing only intermediate care patients,

> "The obvious factors of an increasing demand for nursing home beds and a more restricted supply of such beds have not been overlooked by the business and investment community."

whereas, values of $30,000 to $50,000 per bed may be indicated for an upscale facility catering primarily to private paying patients, including skilled care and located in a major metropolitan area.

Similarly, operating costs ratios vary significantly. An institution entering this financing market would be well advised to have a member of its staff and/or a loan correspondent who is totally familiar with the industry. Providing financing for an existing operating facility, perhaps upon acquisition by a new owner or expansion, is the safest way to enter the market. The historical operations of an existing facility can be scrutinized in some detail, with operating trends projected into the future, taking into consideration any particular changes that may be proposed by new professional management. Proposed new facilities offer more challenge. As with other types of real estate, the examination of comparable operations in the same geographic area provides the best indicator of future operations of a new facility, taking into consideration the proposed management skills, budgeting and marketing plan. Budgets should contain additional working capital to supplement the initial start-up.

Once fully occupied, a well-managed nursing home will generate significant cash flow. Usually, the debt service on a loan of 75 percent of the value (or acquisition cost for an existing facility) will be covered from 1.35× to 1.5× by the net operating income. In today's market, first mortgage loans on nursing homes will generally command a premium of 50 to 100 basis points over comparable first mortgages on more traditional types of real estate. Such yields might be comparable to those available in the financing of hotels and motels but without the risk of possible adverse effects such as economic recession, competition from overbuilding and changing highway patterns. In many cases, multifacility corporate or partnership entities provide significant financial strength to the transaction either by guaranteeing the indebtedness, or through a leaseback of the facility.

As institutional investors periodically review their real estate lending policies, they may wish to consider allocating a portion of their investable funds to the mortgage financing of nursing homes operated by professional operators. With proper management, which can be readily monitored and, to some extent, controlled by the lender, such facilities represent a safe investment secured by a product for which there is demand and limited supply. Additionally, premium yields can still be obtained from this segment of the mortgage financing spectrum. □

Elderly Lifestyles *continued from page 27*

fee for her new living arrangement. She does not want to pay any large up-front fees. She wants the option to change if, in fact, that is what she decides to do.

All of Mary Wainwright's desires can be satisfied by an Adult Congregate Living Facility (ACLF), also referred to by the Federal Housing Administration (FHA) as a Retirement Service Center (RSC).

How do we provide an ACLF for Mary Wainwright? Enter Jim Hentz, a builder/developer who has established an excellent track record building rental apartments. He is very interested in extending his product line and wants to seek markets other than moderate income apartments or condominiums. He is keenly aware that the elderly population in the United States is increasing at a startling rate and sees that the market for senior housing will be substantial for at least the next two decades.

Developer Hentz knows he has the skills to build rental apartments with the amenities required to keep sustained occupancy for moderate income tenants. He does not know, however, what he needs to do to meet the demands of the elderly or how to go about financing a project such as the one Mary Wainwright wants.

An ACLF or RSC can meet the demands of both Mrs. Wainwright and Mr. Hentz.

Michael J. Henderson is a partner with the investment banking firm of Newman and Associates, Inc., Denver, Colorado. He has served as the vice chairman of the Insured Projects Committee of the MBA and has been a member of the FHA and GNMA Liaison Committee. He currently serves on the Elderly Housing Committee.

Criteria

What does the developer need do to pursue a project of this nature? The first step is to select a team. Developing and financing are a team process. A developer can only be as good as the team supporting him. The team must be knowledgeable, organized and compatible. It is extremely important to get as much of the team on board as soon as possible. Team members who are necessary include the following:

- *Developer*—The developer is the team leader, the one paying the bills and taking the risk. He must realize immediately that an ACLF is not simply real estate. It is a business. The majority of professionals today believe the strong builder/developer should subcontract an experienced managing agent who has an understanding of the elderly. A good service company who knows the restaurant business should also be subcontracted. Deep pockets and credibility in the marketplace are key elements for the developer.
- *Market analyst*—Identifying the market is a crucial first step. Many developers, including Oxford, have spent nearly a million dollars in research before doing their first project. Key factors in a demand or market analysis include location and income. Recent studies have shown that only 4 percent of people over the age of 65 move out of their home state. The market, therefore, is in every community in the United States. The ideal site, however, seems to be not more than 25 miles from the person's former residence.

Certainly, another very strong consideration in the demand analysis would be the income profile. The larger the population having an income of $30,000 a year or greater in a specific area, the greater the possibility for success of an RSC.

It is extremely important to use a credible market analyst who understands the market segment which the developer is trying to reach. The more credible the market research, the easier it will be to convince a lender of a real demand.

- *Managing agent*—The managing agent, above all others, is the key team member to have involved from the beginning. The architect may want to design a monument and the builder

continued

James E. Crum

Servicing for Freddie Mac

QUALITY & QUANTITY

The Federal Home Loan Mortgage Corporation, (Freddie Mac) recently celebrated the 15th anniversary of its incorporation. Since it was founded, Freddie Mac's portfolio has grown to nearly 3 million loans serviced by more than 3,000 seller/servicers. The number of eligible loan products has steadily increased, as has the variety of purchase programs under which loans can be sold to Freddie Mac. This flexibility has assured seller/servicers a consistent market for their loans and a reliable source of servicing fee income to offset lean years on the origination side.

In this dynamic and often unpredictable environment, Freddie Mac's portfolio has demonstrated delinquency ratios and REO portfolio levels which are consistently below reported national averages. The quality of portfolio management performed by its seller/servicers is a major factor in achieving these results.

Education and sound principles

Effective servicing is an art that requires the practitioner to have a commitment to excellence, the flexibility to adjust to changing conditions and a sensitivity to the needs of individual borrowers as well as investor requirements. Freddie Mac tries to help its seller/servicers to acquire and refine these skills by providing sound servicing guidelines and requirements and ongoing education about Freddie Mac servicing policies and procedures.

Volume two of the Freddie Mac *Sellers' and Servicers' Guide* outlines the responsibilities of those who service loans on behalf of Freddie Mac. The *Guide* contains a recommended delinquency servicing program which stresses early contact with borrowers, assessment of the true causes of delinquencies and flexibility in structuring repayment plans which will result in the timely reinstatement of the loans. Property inspection requirements and prior approvals of foreclosures and deeds-in-lieu help ensure that seller/servicers have sought other alternatives before taking the costly step of commencing foreclosure. These underlying principles of sound delinquency servicing are supported through an ongoing educational program of seminars and workshops aimed at those people responsible for the daily activities related to Freddie Mac's portfolio.

Making the most of limited resources is another key factor in achieving success as a Freddie Mac seller/servicer. Wherever it is prudent to do so, Freddie Mac has delegated to its seller/servicers the authority to act on its behalf. Transfers of ownership, partial releases, insurance claim proceeds and cancellation of MI coverage are just some of the routine actions a seller/servicer can perform without prior approval, subject only to the conditions specified in the *Sellers' and Servicers' Guide*. In jurisdictions where it is permitted and where seller/servicer performance warrants it, Freddie Mac will grant a limited power of attorney to execute most documents which might otherwise require Freddie Mac execution.

Reporting to Freddie Mac is also simple. Delinquency reporting consists of just three basic forms each month, one of which is produced by Freddie Mac. Accounting reports can be transmitted electronically (except for certain transactions). Again, seminars and workshops are available to keep staff members current on Freddie Mac requirements.

ILLUSTRATION BY DENNIS WILSON

Finally, the *Sellers' and Servicers' Guide* details administrative responsibilities for those servicing Freddie Mac portfolios. Mortgage file documentation requirements, note custody conditions, fidelity and E&O coverage guidelines and other duties are specified. These conditions of doing business with Freddie Mac reflect the need to properly identify, protect and service the nearly 3 million loans in which Freddie Mac holds an interest.

On-site review program

Freddie Mac monitors the performance of its portfolio and its seller/servicers using a variety of factors. The accuracy and timeliness of reports and funds remittances, the level of delinquencies by location and loan type, the number of REO properties held and the quality of servicing activities are a few of these factors. Freddie Mac also performs reviews of seller/servicer operations, including physical inspections of their records and vaults, discussions with managers and staff and verifications of the seller/servicers' delinquency and accounting trial balances against reports submitted to Freddie Mac. On-site reviews are conducted for both institutions with good servicing records as well as those whose performance indicates a weakness in one or more servicing responsibilities. By identifying problems early and working together, Freddie Mac and its seller/servicer can assure that the loans are properly serviced and that the institution maintains eligibility for a number of special benefits such as preferred seller status and special deal considerations.

Chart 1 outlines the major problem areas identified during the on-site review program conducted the first half of 1985. Although 17 problems were identified during these reviews, four of them constitute 63 percent of the discrepancies noted. The four include:

- *Property inspections not conducted.* Freddie Mac considers property inspections to be an important element of a successful collection policy. Inspections must be conducted within the first 60 days of delinquency (90 days for FHA/VA loans), if there has been no agreement to a repayment plan. Monthly inspections are also required for all loans in the process of foreclosure and REO properties. These inspections provide an opportunity for face-to-face contact with borrowers, determination of occupancy status and property condition and are also important for determining if an abandonment has occurred which will trigger IRS reporting.
- *Mortgage files not identified.* All mortgage files, including separate collection files, insurance files and other records relating to mortgages sold in whole or part to Freddie Mac must be identified with Freddie Mac's loan number and percentage of participation. Notes securing mortgages sold in part to Freddie Mac must be identified with the Freddie Mac loan number on the face of the note. There are two reasons for this requirement. First, the seller/servicer protects itself from inadvertently pledging, hypothecating or reselling a loan in which Freddie Mac holds an interest. Second, Freddie Mac's staff will be able to quickly identify and deal with only those loans in its portfolio when it conducts an on-site review of the seller/servicer. In today's financial environment, this simple tool can prevent mistakes which might threaten a seller/servic-

continued

"Effective servicing is an art that requires the practitioner to have a commitment to excellence, the flexibility to adjust to changing conditions and a sensitivity to the needs of individual borrowers as well as investor requirements."

James E. Crum is director of loan servicing for the Federal Home Loan Mortgage Corporation, Washington, D.C.

Previous to coming to Washington, D.C., Mr. Crum was regional director of loan servicing in the Northcentral region of Freddie Mac.

CHART 1

Freddie Mac Seller/Servicer On-Site Review Results 1/1/85 - 6/30/85

Property inspections not conducted	22.50%
Failure to properly identify loan files with FHLMC ownership, interest and/or loan number	19.17%
Overall collection procedures weak	13.33%
Incorrect monthly reporting	11.66%
Slow in reporting foreclosures to attorney	5.85%
Overall high delinquency rates	5.00%
No loan files on-site to review	5.00%
REO files unorganized and not up-to-date	4.17%
S/S referring foreclosures before receiving FHLMC consent	2.50%
S/S submitting *MI* reports late	2.50%
Overall servicing procedures inadequate	1.67%
S/S had transferred servicing and problems arose	1.67%
Notes incorrectly endorsed	1.67%
REO not disposed of efficiently	.83%
Management or personnel turnover affecting performance	.83%
Taxes not being paid as promised by S/S	.83%
Foreclosure monitoring procedures inadequate	.83%
	100.00%

er's relationship with Freddie Mac.

▪ *Incorrect monthly reporting.* In more than 13 percent of its reviews during the first half of this year, Freddie Mac discovered discrepancies between the seller/servicer's delinquency trial balances and the monthly reports filed with Freddie Mac. Most of these errors resulted from inadequate training of the people preparing the reports.

Freddie Mac defines a loan as being delinquent when any part or all of monthly payment of principal, interest and where applicable, escrow remains unpaid at the close of business on the day before its next scheduled due date. Thus, a payment due January 1 is delinquent one month if it is unpaid in whole or part (exclusive of any late charge) upon the close of business January 31. Other errors result from failing to notify Freddie Mac of a change in a loan's status. If, as an example, a loan is reinstated from foreclosure on the seller/servicer's books, but Freddie Mac is not informed of the reinstatement, an error in reporting will result.

"More than ever before, seller/servicers will need the 'right stuff' to achieve success in the dual goals of a growing portfolio and quality servicing performance."

▪ *Overall collection procedures are weak.* Freddie Mac recommends a delinquency servicing program which deals with borrowers early in the delinquency. Lack of telephone contact with a borrower before the loan becomes 30 days past due or face-to-face contact before the 60th day of delinquency are common factors among seller/servicers with higher than average delinquency ratios.

Many seller/servicers enter into repayment plans with borrowers without a clear understanding of the borrowers' ability to meet their promises. Quality servicing of delinquent loans requires counseling, not merely collection techniques. Collection staff members must determine the cause of the delinquency in order to define the cure. While computer-generated payment reminders and form letters are useful collection tools, they cannot replace personal contact aimed at solving the borrower's problem.

Freddie Mac's on-site review program is designed to help seller/servicers identify operational weaknesses and to recommend specific actions which will improve their performance. Its goal is to develop a bond of cooperation and trust between Freddie Mac and its customers which will strengthen their relationship and expand their business opportunities.

Looking ahead

As Freddie Mac's portfolio continues to grow, the corporation will be looking for ways to make servicing its portfolio easier and more efficient. Among items under consideration is a new delinquency reporting system which will eliminate many of the forms currently required on a monthly basis. This new system would be integrated with the accounting reports and lend itself to automation via Freddie Mac's MIDANET® system.

Freddie Mac will also be expanding its on-site review program, both in terms of the number of reviews conducted each year and in the areas of activity to be checked. As the seller/servicer base and portfolio grow, the corporation will be concentrating its resources on those aspects of servicing which offer the greatest risk of loss. More than ever before, seller/servicers will need the "right stuff" to achieve success in the dual goals of a growing portfolio and quality servicing performance. These goals call for a competent staff, strong internal controls, effective policies and procedures and most important—the commitment to excellence. □

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MORTGAGE MARKET TRENDS

Following a lethargic first half, when real GNP grew only at a 1 percent annual rate, economic activity picked up modestly in the third quarter. The preliminary estimate for the rate of GNP growth in that quarter is 3.3 percent. Federal government spending increased sharply in the third quarter and consumer spending remained strong, led by increased purchases of automobiles. Continuing strength in the housing sector also provided some support.

Between July and September, federal government purchases of goods and services amounted to $347 billion at a seasonally adjusted annual rate. This represented about a 7 percent increase over the second quarter. Part of this increase was in defense purchases, which often bounce erratically on a quarterly basis. Purchases by the Commodity Credit Corporation also jumped in the third quarter.

Spurred by moderate rates of inflation in general and by cut-rate auto financing incentives specifically, consumer outlays rose vigorously during the third quarter. Led by robust automobiles sales, retail sales were up 2.3 percent in August and by 2.1 percent in September. Auto sales alone rose by almost 7 percent and 8 percent, respectively in August and September. Sales of nondurable goods also rose at a healthy pace. Both auto sales and total retail sales were down in October.

Growth in employment continued to be quite healthy in the third quarter. Despite the fact that the civilian unemployment rate has remained near its present level of 7.1 percent, the actual number of people who are employed has risen quite substantially this year. Through the third quarter, almost 1.7 million new jobs had been created and in October nonfarm payroll, employment rose by another 414,000.

In the housing area, continuing high levels of sales activity for both new and existing homes has been another positive component of economic growth. Existing homes are currently selling at an annual rate of over 3.4 million units, the highest level since November 1979. Sales of new homes, while not breaking records, are selling at close to an annual rate of 700,000 units. Housing starts, although unexpectedly weak in September, should return shortly to at least the 1.7 million unit level that prevailed as recently as August. Construction activity as a whole has also been strong, as evidenced by the 2 percent rise in construction spending in September, to a seasonally adjusted annual rate of $350 billion. The bulk of the rise in construction spending came in the nonresidential area, especially in office and other commercial buildings.

The continuing stability or slight declines in interest rates across a broad spectrum of short- and long-term maturities, including mortgage rates, has contributed to the strength of the housing sector and to the overall pickup in economic activity during the third quarter. Currently, short-term rates are averaging around 7.3 percent and yields on long-term government securities are approaching 10.5 percent. In addition, commitment rates on fixed-rate mortgages are averaging about 12.6 percent and for adjustable rate mortgages, they are about 10.6 percent.

In so far as the economic outlook is concerned, it would not be reasonable to expect consumer spending to continue at its recent pace. The personal savings rate is very low and consumer installment debt is now at a relatively high level. The contributions of consumer spending to overall economic growth, therefore, seem likely to diminish.

In addition, two recent surveys, one by McGraw-Hill Inc. and the other by Merrill Lynch, indicate that in 1986, business spending on new plant and equipment will rise relatively little, if at all. However, positive factors include rising auto production in the fourth quarter, continued high levels of federal government spending, particularly in defense and a lessened drag on the economy from the trade sector, as the impact of the declining dollar begins to take effect.

On balance then, over the next six to twelve months, we expect the economy to expand to an annual rate of between 2 and 3 percent, with growth leaning toward the lower end of the range through the Winter, then picking up somewhat, later in 1986. Based on this forecast, we anticipate that interest rates should remain stable or decline moderately over the near-term. This stability in interest rates should bode well for the housing sector, where sales and construction activity are expected to remain healthy through most of next year.

Robert Rosenblatt
Assistant Economist
November 15, 1985

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rate			Actual			Seasonally Adjusted Annual Rate		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985												
APR	175	118	57	1,933	1,268	665	160	105	55	1,704	1,066	638
MAY	170	118	52	1,681	1,148	533	171	109	62	1,778	1,064	714
JUN	163	110	53	1,701	1,123	578	156	100	56	1,712	1,091	621
JUL	160	114	46	1,663	1,148	515	158	103	55	1,694	1,088	606
AUG	162	110	52	1,746	1,168	578	159	101	58	1,784	1,117	667
SEP$_P$	**145**	**96**	**49**	**1,583**	**1,042**	**541**	**166**	**93**	**73**	**1,796**	**1,066**	**730**
1983 TOTAL	1,703	1,181	522				1,605	1,035	570			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
9 MONTHS												
1985	1,322	902	420				1,328	840	488			
1984	1,372	943	429				1,315	844	471			
1983	1,300	918	382				1,229	800	429			
1982	760	540	220				711	452	259			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rate				Actual				Seasonally Adjusted Annual Rate			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1985																
APR	26	22	80	48	293	247	874	519	24	22	71	43	258	223	760	463
MAY	25	29	72	45	237	257	744	443	28	27	72	45	267	263	784	464
JUN	27	27	67	42	284	239	737	441	26	25	64	42	275	254	743	440
JUL	23	23	70	44	208	217	783	455	23	26	66	43	238	256	754	446
AUG	25	25	66	44	230	241	751	524	25	25	65	44	266	259	770	489
SEP$_P$	**24**	**23**	**60**	**38**	**224**	**229**	**693**	**437**	**26**	**24**	**65**	**51**	**251**	**227**	**754**	**564**
1983 TOTAL	168	218	935	382					164	188	863	390				
1984 TOTAL	204	243	866	436					201	212	812	457				
9 MONTHS																
1985	182	181	596	363					198	180	576	374				
1984	146	187	692	347					148	162	642	364				
1983	129	166	712	293					125	143	664	298				
1982	84	107	425	144					75	91	386	157				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands) EXISTING HOUSES[1]	NEW HOMES Sold	NEW HOMES Available For Sale	NEW HOMES Months Supply at Current Rate	VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in millions) Seasonally Adjusted Annual Rate Total	1 Unit	2+ Units	Non-res.	CONSTRUCTION STATUS (Units in thousands) Seasonally Adjusted Annual Rate Under Construction Total	1-4 Units	5+ Units	Completions Total	1-4 Units	5+ Units
1985														
APR	283	60	354	6.7	$203,684	$84,000	$28,500	$91,184	1,088	643	445	127	91	36
MAY	297	65	355	6.4	201,472	83,676	28,360	89,436	1,089	644	445	132	85	47
JUN	297	65	355	6.1	198,405	82,926	29,233	86,246	1,075	634	441	164	108	56
JUL	311	62	354	5.9	199,236	83,572	29,475	86,189	1,073	636	437	146	100	46
AUG	337	59	354	6.0	201,903	84,245	29,547	88,111	1,086	643	443	153	103	50
SEP[P]	**380**	**54**	**356**	**6.6**	**207,816**	**84,130**	**31,327**	**92,359**	**1,066**	**626**	**440**	**156**	**109**	**47**
1983 TOTAL	2,719	623										1,390	1,016	374
1984 TOTAL	2,868	639										1,652	1,137	515
9 MONTHS														
1985	2,551	535										1,244	845	399
1984	2,250	505										1,210	835	375
1983	2,113	478										974	709	265
1982	1,503	301										715	506	209

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Unit Type
(Dollars in millions)

YEAR AND MONTH	TOTAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	1-4 UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JAN	$20,183	$ 4,004	$ 7,922	$ 7,323	$ 93[illegible]	$ 13,591	$ 3,894	$ 5,722	$ 3,927	$ 48
FEB	20,961	4,273	7,941	7,351	1,396	12,944	3,717	5,618	3,555	54
MAR	25,406	4,333	10,681	8,350	2,042	16,517	4,037	7,887	4,502	91
APR	26,120	4,849	11,955	7,403	1,913	17,909	4,467	9,178	4,208	56
MAY	28,212	4,548	13,096	8,519	2,049	19,602	4,377	10,268	4,897	60
JUN[P]	**32,550**	**5,402**	**12,665**	**12,370**	**2,113**	**20,917**	**5,052**	**9,551**	**6,232**	**82**
1983 TOTAL	276,371	65,050	103,882	91,500	15,939	193,535	55,680	81,524	55,605	726
1984 TOTAL	297,406	53,160	129,482	97,776	16,988	196,139	44,500	96,187	54,626	826
6 MONTHS										
1985	153,435	27,409	64,260	51,319	10,447	101,481	25,544	48,224	27,322	391
1984	150,808	30,460	64,836	47,948	7,564	102,450	25,410	48,992	27,645	403
1983	126,145	33,860	44,644	41,714	5,927	89,407	28,390	35,322	25,338	357
1982	55,367	11,480	18,504	21,528	3,855	36,305	9,000	15,079	11,998	228

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JAN	$ 1,228	$ 36	$ 691	$ 399	$ 102	$ 5,364	$ 74	$ 1,509	$ 2,997	$ 784
FEB	1,830	378	923	396	133	6,187	178	1,400	3,400	1,209
MAR	2,020	170	1,162	511	177	6,869	126	1,632	3,337	1,774
APR	1,937	163	1,223	406	145	6,274	219	1,554	2,789	1,712
MAY	1,992	34	1,238	505	215	6,618	137	1,590	3,117	1,774
JUN[P]	2,329	228	1,417	590	94	9,304	122	1,697	5,548	1,937
1983 TOTAL	19,443	3,840	8,521	5,485	1,597	63,393	5,530	13,837	30,410	13,616
1984 TOTAL	22,125	1,980	13,160	5,519	1,466	79,142	6,680	20,135	37,631	14,696
6 MONTHS										
1985	11,337	1,009	6,654	2,808	866	40,617	856	9,382	21,189	9,190
1984	11,829	1,830	6,427	2,861	711	36,529	3,220	9,417	17,442	6,450
1983	9,643	2,990	3,710	2,475	468	27,095	2,480	5,612	13,901	5,102
1982	3,159	740	1,232	958	229	15,903	1,740	2,193	8,572	3,398

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JAN	$ 17,115	$ 2,798	$ 9,207	$ 3,548	$ 1,562	$88,853	$8,463	$49,556	$16,711	$14,123
FEB	20,485	3,695	10,564	3,624	2,602	92,165	8,987	50,899	16,994	15,285
MAR	28,222	3,404	14,217	7,831	2,770	98,340	8,921	53,175	21,748	14,496
APR	24,853	3,897	14,893	3,798	2,265	97,905	10,616	55,146	15,865	16,278
MAY	25,999	4,355	15,100	4,115	2,429	98,643	10,108	55,898	16,223	16,414
JUN[P]	27,447	5,087	14,174	5,385	2,801	125,455	11,220	78,076	19,126	17,033
1983 TOTAL	260,343	81,070	123,361	38,195	17,717					
1984 TOTAL	264,193	50,100	146,184	47,065	20,844					
6 MONTHS										
1985	144,552	23,236	78,155	28,305	14,856					
1984	141,883	27,390	77,593	25,650	11,250					
1983	126,101	43,390	56,024	18,114	8,573					
1982	48,974	17,670	18,789	9,290	3,225					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1985												
APR	188	67	19	102	110	$ 7,103	35	$ 2,007	14	$ 944	61	$ 4,152
MAY	189	70	19	100	98	6,429	20	1,185	13	868	65	4,376
JUN	192	80	19	93	112	7,330	36	2,118	14	961	62	4,251
JUL	218	93	24	101	96	6,558	11	656	16	1,104	69	4,798
AUG	216	88	25	103	114	7,646	28	1,644	19	1,275	67	4,727
SEP[P]	201	82	26	93	129	8,545	47	2,771	19	1,318	63	4,456
1983 TOTAL	1,921	777	261	883	1,302	79,469	367	19,141	283	17,965	652	42,363
1984 TOTAL	1,862	477	180	1,205	1,345	86,777	200	10,644	199	12,730	946	63,403
9 MONTHS												
1985	1,653	660	178	815	919	60,197	234	13,590	133	8,887	552	37,720
1984	1,419	318	154	947	1,072	69,184	169	9,006	161	10,352	742	49,826
1983	1,541	639	270	632	941	56,106	296	14,921	207	12,986	438	28,199
1982	650	240	95	315	388	21,266	72	3,254	70	4,024	246	13,988

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC Comm. to Sell	FHLMC Comm. to Buy	FHLMC Mtg. Purc.	FHLMC Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1985										
APR	$ 1,921	$ 1,515	$40,952	$ 1,856	$ 4,672	$ 4,141	$ 2,201	$ 1,973	$ 2,230	$ 2,558
MAY	2,074	1,703	41,613	1,004	3,375	3,701	3,591	4,240	6,073	3,595
JUN	1,593	1,904	42,755	1,519	4,101	5,172	4,106	3,281	3,324	3,609
JUL	1,583	1,918	43,891	1,527	2,714	3,258	4,626	4,385	9,086	3,859
AUG	1,797	1,921	45,668	2,207	3,858	3,958	3,602	2,685	5,872	4,153
SEP	**1,638**	**1,739**	**48,769**	**3,654**	**2,757**	**2,919**	**4,219**	**4,501**	**6,927**	**4,403**
1983 TOTAL	18,606	17,558	—	13,081	30,921	32,846	22,952	21,376	70,461	50,495
1984 TOTAL	21,008	16,722	—	13,546	30,743	32,601	21,885	20,489	36,101	27,859
9 MONTHS										
1985	15,435	16,457	—	15,587	31,446	34,488	31,021	28,589	46,024	30,303
1984	14,461	12,376	—	9,903	20,359	21,606	12,642	11,590	27,527	21,882
1983	14,257	12,762	—	11,108	24,997	26,452	17,043	15,674	58,142	40,288
1982	14,831	9,490	—	7,529	23,062	22,962	15,838	15,987	32,783	10,675

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA NEW[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA Mandatory Delivery Yields ARM (5 yr. Treas.)	FNMA Mandatory Delivery Yields Conv.	APARTMENTS[5]
1985								
MAY	12.28%	12.49%	12.50%	12.06%	12.09%	12.038%	12.281%	13.34%
JUN	11.89	12.06	12.06	11.75	11.76	11.125	11.600	13.38
JUL	12.12	12.09	12.10	11.38	11.48	11.000	11.569	13.22
AUG	11.99	12.06	12.04	11.24	11.33	11.238	11.719	13.23
SEP	12.04	12.02	12.03	11.17	11.20	11.200	11.775	13.21
OCT$_P$	**n.a.**	**n.a.**	**n.a.**	**11.02**	**11.30**	**10.675**	**11.588**	**13.03**

CURRENT SECONDARY MARKET YIELDS

YEAR AND MONTH	GNMA[6]	FNMA[6]	FHLMC[6]
1985			
MAY	11.89%	—%	—%
JUN	11.20	11.20	11.23
JUL	11.26	11.30	11.27
AUG	11.39	11.38	11.42
SEP	11.41	11.43	11.47
OCT	**11.24**	**11.28**	**11.34**

SELECTED SECURITIES

YEAR AND MONTH	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1985				
MAY	12.25%	10.85%	7.65%	7.83%
JUN	11.62	10.16	7.09	7.35
JUL	11.64	10.31	7.20	7.56
AUG	11.77	10.33	7.32	7.72
SEP	11.87	10.37	7.27	7.83
OCT	**11.82**	**10.24**	**7.33**	**7.80**

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1985				
MAY	3	104	—	—
JUN	25	104	104	107
JUL	35	95	99	96
AUG	22	106	105	109
SEP	22	104	106	110
OCT	**n.a.**	**100**	**104**	**110**

n.a.—Not available. p—Preliminary.

[1] From the National Association of Realtors "Existing Home Sales" series.

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

NOT SEASONALLY ADJUSTED

YEAR AND MONTH	Total	1-4 Units				5+ Units			Non-[3] res.
		Total	FHA	VA	Conv.	Total	FHA	Conv.	
1984									
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430
AUG	3,570	3,070	520	380	2,170	0	0	0	500
SEP	3,050	2,400	550	380	1,470	70	70	0	580
OCT	3,700	3,110	820	470	1,820	0	0	0	590
NOV	3,370	3,090	820	470	1,800	0	0	0	280
DEC	**5,250**	**4,090**	**1,280**	**690**	**2,120**	**80**	**0**	**80**	**1,080**
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680
12 MONTHS[5]									
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910

SEASONALLY ADJUSTED

YEAR AND MONTH	Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984				
JUL	$3,530	$2,960	$ 0	$460
AUG	3,120	2,600	0	510
SEP	3,380	2,500	120	780
OCT	3,600	2,920	0	750
NOV	3,890	3,610	0	280
DEC	**4,880**	**3,860**	**70**	**770**

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

COMMITMENTS DURING MONTH

YEAR AND MONTH	To Borrowers				From Investors			
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450
AUG	2,920	2,630	0	290	4,220	3,380	10	830
SEP	2,910	2,640	30	240	2,760	2,400	80	280
OCT	3,910	3,240	0	670	4,550	4,090	30	430
NOV	3,430	2,820	0	610	3,880	2,760	170	950
DEC	**5,480**	**4,090**	**430**	**960**	**4,850**	**3,910**	**80**	**860**
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570
12 MONTHS[5]								
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550

OUTSTANDING COMMITMENTS END OF MONTH

YEAR AND MONTH	To Borrowers			From Investors		
	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.
1984						
JUL	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	7,430	40	500	7,730	210	1,600
SEP	7,350	300	500	7,460	480	800
OCT	7,660	170	540	8,400	370	740
NOV	7,460	40	690	6,940	270	1,050
DEC	**7,850**	**100**	**750**	**7,810**	**260**	**1,170**

OUTSTANDING END OF MONTH INVENTORY[1]

YEAR AND MONTH	Total	1-4 Units				5+ Units			Non-res.[3]
		Total	FHA	VA	Conv.	Total	FHA	Conv.	
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	**6,840**	**6,090**	**1,500**	**980**	**3,610**	**170**	**0**	**170**	**580**

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4] 1-4 Units	COVERAGE[4] 5+ Units	COVERAGE[4] Non-[3] res.	SERVICING VOLUME[1] Total	SERVICING VOLUME[1] 1-4 Units	SERVICING VOLUME[1] 5+ Units	SERVICING VOLUME[1] Non.[3] res.	NOTES PAYABLE[1] (End of Month Balances) Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	**56**	**96**	**88**	**385,270**	**321,620**	**33,110**	**30,540**	**42,280**	**8,390**	**23,680**	**10,210**

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED Total	1-4 Units	5+ Units	Non-[3] res.	DISBURSEMENTS DURING MONTH Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	END OF MONTH INVENTORY Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	**470**	**270**	**120**	**80**	**430**	**220**	**30**	**180**	**470**	**9,240**	**3,790**	**790**	**4,660**	**3,440**

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH Total	1-4 Units	5+ Units	Non-[3] res.	END OF MONTH BALANCES Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	**790**	**200**	**10**	**580**	**3,910**	**930**	**280**	**2,700**

Notes: [1] All dollar amounts are in millions.

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data.

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year-to-date seasonally adjusted series not calculated.